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June 17, 2005

Eric Solomon
Deputy Assistant Secretary for
Regulatory Affairs and Acting
Deputy Assistant Secretary (Tax
Policy)
Department of the Treasury
Room 3104 MT
1500 Pennsylvania Avenue, NW
Washington, DC 20220

The Honorable Donald L. Korb
Chief Counsel
Internal Revenue Service
Room 3026
1111 Constitution Avenue, NW
Washington, DC 20224

Re: CIRCULAR 230 - IMPACT OF SECTION 10.35 ON THE U.S. CAPITAL MARKETS

Dear Deputy Assistant Secretary Solomon and Chief Counsel Korb:

The Bond Market Association (the "Association")¹ is submitting this letter on behalf of its members to express concerns about the impact that the final regulations under Circular 230, and specifically Section 10.35 of those regulations, will have on securities offerings in the U.S. capital markets carried out pursuant to Rule 144A under the Securities Act of 1933 (the "1933 Act"). We understand from public statements of Treasury officials that the scope of the definition of "marketed opinions" under the regulations is under review. We ask that our comments be considered in that context. As

¹ The Association is an international trade association representing approximately 200 securities firms and banks that underwrite, distribute and trade in fixed income securities internationally. More information about the Association and its members and activities is available on its website www.bondmarkets.com.

explained below, we believe that the tax disclosure in capital markets offerings pursuant to Rule 144A should be excepted from the definitions of marketed opinion and reliance opinion under the regulations, just as offerings registered with the SEC are excepted.²

I. INTRODUCTION

The U.S. capital markets for fixed income securities--debt securities (including convertible securities) and preferred stock -- are substantial by any measure. In 2004, corporations raised \$500 billion in fixed income offerings registered with the SEC and \$257.8 billion in unregistered Rule 144A offerings.³ The U.S. capital markets are recognized as the most efficient and liquid capital markets in the world. These attributes derive, in part, from the established practices and expectations of the participants in these markets and also from the ability of federal securities regulators to adapt the regulatory structure as needed to keep pace with the evolution of capital markets practices. Issuers and investors view our capital markets as appropriately balancing the competing interests of providing ready access to the markets while at the same time affording investors with appropriate protections for their investments.

As currently written, Section 10.35 will unsettle established market practices and expectations in the case of unregistered offerings pursuant to Rule 144A. Our main concern is that the tax disclosures in Rule 144A offerings will be subject to the rules for marketed opinions and reliance opinions, even in the case of offerings that are viewed as raising no significant tax issues. Offerings of preferred stock and convertible debt, and

² On March 1, 2005, the Association submitted a comment letter that addressed issues raised by Circular 230 with respect to state and local bond opinions. The issues discussed in this letter are distinct from those discussed in our March 1 letter.

³ The vast majority of Rule 144A transactions involve fixed income or convertible securities. Rule 144A is not available for offerings of publicly-traded equity securities.

perhaps even straight debt, could be viewed as having “a significant purpose of tax avoidance” on the part of investors because of favorable tax attributes such as the dividends received deduction, the taxation of convertible debt as compared to the taxation of an investment unit, and the portfolio interest exception on interest payments to non-U.S. residents. To the extent an issuer elects to utilize the Rule 144A market to execute such a transaction, the impact of this regulation could be to unnecessarily increase the cost of executing transactions that raise none of the issues sought to be addressed by Circular 230.

We recommend that the regulations be amended to exclude capital market offerings exempt from registration under Rule 144A from the definition of marketed opinion and reliance opinion. We also urge that you consult with the SEC to obtain their views (if you have not already done so) in order to ensure that the Internal Revenue Service and the SEC are not working at cross purposes.⁴

II. THE U.S. CAPITAL MARKETS

A. U.S. Capital Markets are Well Established and Efficient Markets

As noted above, the U.S. capital markets are well established and efficient markets. This is true for both equity and debt securities. However, given our concern about the impact of Circular 230 on the Rule 144A markets, which is principally a market for fixed income and convertible securities, we will focus on those markets for the purpose of this letter.

⁴ We are sending copies of this letter to the Commissioners and senior staff of the SEC.

At March 31, 2005, there were approximately \$4.9 trillion in corporate bonds outstanding in the United States.⁵ Rule 144A issuance volume has averaged over \$250 billion annually over the past five years, or over 30% of all corporate bond issuance activity during that period. While corporate bonds and convertibles are typically not listed on a national securities exchange or on the NASDAQ Stock Market, price information is widely available for a very high proportion of all outstanding bonds and convertibles on a real-time basis. The ready availability of this pricing information, coupled with the breadth and depth of these markets, are significant reasons why the U.S. fixed income markets are among the most well-developed and liquid in the world.

B. Offerings are Subject to the Securities Laws and SEC Regulations, with an Emphasis on Disclosure

Offers and sales of securities are governed at the federal level by the 1933 Act.⁶ Under Section 5 of the 1933 Act, any offer or sale of a security must be registered with the SEC unless either the security or the transaction in question is exempt. Registration is effected by filing a registration statement with the SEC, which contains an offering document, or prospectus, and certain additional information and exhibits.

SEC regulation of capital formation transactions is often referred to as a “disclosure based” regulatory system, rather than a “merit based” regulatory system. In other words, the SEC requires that issuers and other participants in capital formation transactions prepare a registration statement and a prospectus containing accurate

⁵ This data includes medium-term notes and excludes (i) securities issued by government-sponsored entities, such as Fannie Mae and Freddie Mac, (ii) certificates of deposit, (iii) debt with an initial maturity of less than one year and (iv) asset-backed securities.

⁶ State securities or “blue sky” laws also apply to offers and sales of securities. These laws largely dovetail with federal securities law in terms of disclosure requirements, to the extent they are not otherwise preempted.

disclosure regarding certain mandated topics. SEC review of offering documentation (which occurs with respect to some, but not all, such filings) seeks to ascertain whether this disclosure is appropriately responsive to these requirements. The SEC does not review, nor does it pass upon, the relative merits of a particular investment opportunity.

The principal means by which issuers and other market participants are incented to prepare accurate disclosure is a series of liability standards contained in the federal securities laws.⁷

- *Section 11 of the 1933 Act* – This statutory provision imposes strict liability on the issuer for any material misstatement or omission contained in a registration statement or prospectus. Underwriters and outside directors are also subject to liability, but may establish a defense if they performed a reasonable investigation of the disclosure in question (the so-called “due diligence” defense). Accountants and other experts are also subject to liability for material misstatements or omissions contained in portions of the prospectus that their expert opinion covers. This expert liability is not strict, but is subject to a higher standard of responsibility than that which is imposed on underwriters and outside directors.
- *Section 12(a)(2) of the 1933 Act* – This statutory provision imposes liability on the issuer, underwriters and directors for material misstatements or omissions contained in the prospectus or any other document used in connection with the sale of a security. A defense is available to persons who exercised reasonable care in evaluating the adequacy of the disclosure in question.
- *Rule 10b-5 under the 1934 Act* – This regulatory provision imposes liability on any market participant that uses any scheme or artifice to defraud in connection with the offer or sale of any security. As

⁷ In addition to the following provisions, federal securities law proscribes behavior constituting intentional or willful fraud. See Section 17(a) of the 1933 Act. In addition, any person who controls an issuer is subject to the same degree of liability as is imposed on the issuer due to such person’s control person status. See Section 15 of the 1933 Act and Section 20 of the Securities Exchange Act of 1934 (the “1934 Act”).

interpreted by the courts, this rule requires a plaintiff to establish that the defendant acted with intent to defraud.

Against this overlay of liability provisions, there are two principal methods by which issuers raise capital in the capital markets:

- *Registered Offerings* – Issuers can register an offering of securities with the SEC. Once a registration statement is declared effective by the SEC, the issuer may offer and sell the registered securities to investors pursuant to the terms of the registration statement.
- *Private Placements, Including Rule 144A Transactions* – The principal exemption from SEC registration that is relied upon by issuers in capital formation transactions is the exemption for “transactions by an issuer not involving any public offering” (the so-called “private placement” exemption). These offerings are limited to investors of sufficient means and experience that they do not need the protections afforded by the registration provisions of the 1933 Act. There are two principal categories of private placements:
 - Rule 144A Offerings – Rule 144A under the 1933 Act permits offerings to be made without registration to Qualified Institutional Buyers (“QIBs”) This term encompasses institutional investors with substantial assets invested in the capital markets (a minimum of \$100 million for most QIBs, or a minimum of \$25 million for broker-dealers). Rule 144A securities can be resold to other QIBs with relative ease, and these resales can clear and settle in book entry form via The Depository Trust Company in the same manner as registered securities. As noted above, Rule 144A is not available for offerings of publicly traded equity securities.
 - Private Placements to Accredited Investors – Private placements may be made to “institutional accredited investors,” which are defined under the 1933 Act as institutional investors meeting definitions far less restrictive than the definition of QIBs under Rule 144A.⁸ These

⁸ It is possible to offer and sell securities in private placements pursuant to Section 4(2) and Regulation D to individual accredited investors in addition to institutional accredited investors. However, it is not common in private placement capital formation transactions to include individuals among the offerees.

transactions rely upon the exemption afforded by Section 4(2) of the 1933 Act and Regulation D thereunder. Unlike Rule 144A securities, securities privately placed to accredited investors are much more difficult to resell, requiring delivery of legal opinions in many instances. Therefore, subsequent resales to accredited investors cannot clear and settle via DTC in book-entry form. Instead, resales must clear and settle via physical delivery, which is much more cumbersome and prone to administrative delay and failure.

Since its adoption in 1991, Rule 144A has become a very common means by which issuers access the institutional capital markets (such as mutual funds, pension funds and asset managers). Often the issuer agrees to subsequently register the Rule 144A securities with the SEC, or to incur potentially substantial financial penalties if it fails to do so by a specified deadline.

C. Disclosure Practices in the Rule 144A Market

The documentation used for Rule 144A offering materials has evolved to closely follow that which is used in transactions registered with the SEC. In particular, tax disclosure in Rule 144A transactions is substantively identical to tax disclosure in registered transactions, except in very rare circumstances. On the other hand, disclosure practices (tax and otherwise) for other private placements are far more variable.⁹ Established practice in Rule 144A transactions is to give full disclosure of risks, including tax risks. We are not aware of any concerns having been raised by IRS with

⁹ It is common in Rule 144A transactions for the issuer to have the ability to place some of the securities with accredited institutional investors in concurrent private placements using the same offering document. These options are not always exercised by the placement agents and, if they are exercised, rarely constitute more than a small percentage of the total distribution. We therefore believe that a Rule 144A transaction with a concurrent private placement option for institutional accredited investors should still constitute a Rule 144A transaction for purposes of the exemptive proposal set forth above.

respect to tax disclosure in the taxable capital market offerings (as distinct from tax-exempt municipal bond offerings).

III. IMPACT OF SECTION 10.35

As noted above, we believe that tax disclosure in Rule 144A transactions will constitute a marketed opinion and a reliance opinion under Section 10.35 as currently drafted. This is because there will often be (at least theoretically) a significant purpose of tax avoidance for investors in fixed income and convertible debt or preferred stock transactions. Under the regulations, tax disclosure will constitute a marketed opinion and a reliance opinion even if there is no significant tax issue -- i.e., an issue as to which the IRS would have a reasonable basis for a successful challenge. We expect that under the terms of the regulations, investors will not be motivated by the principal purpose of tax avoidance in such a transaction, because they will be making a significant capital investment as a means to most effectively put their money to work while at the same time seeking to diversify risk by investing in different instruments and different issuers.

We also think it is unlikely that issuers will include tax disclosure in a Rule 144A offering document that satisfies the requirements of a “covered opinion” under Section 10.35(c). In the vast majority of capital formation transactions under Rule 144A or pursuant to SEC registration, no novel tax issues are presented. The current level of disclosure in typical tax sections has evolved over time to be responsive to the needs of the investor community. In the context of Rule 144A transactions, in which offerees are by definition significant institutional investors, the audience for the tax disclosure is able to compel more detailed tax disclosure from the issuer if they perceive it to be necessary to enable them to make an informed investment decision. We believe that the relative

consistency of approach in tax disclosure in these documents supports our argument that offerees do not need the more detailed disclosures required by Section 10.35.

As a result, we believe that issuers will in most instances include the legends permitted under Section 10.35 that will cause the written advice not to be subject to the requirements for covered opinions under the regulations. However, we believe that certain of the mandated legends will present issues that are inconsistent with established practices and expectations in the Rule 144A markets and could have unintended adverse effects on participants in capital formation transactions. We discuss each of the mandated legends below.

- *Investors should consult their independent tax advisor.* We believe that this legend is innocuous. This instruction is already included in virtually all tax disclosure in Rule 144A offering documentation, due to the difficulty an issuer would have anticipating all tax issues that a potential investor may need to consider in making an investment decision with respect to a particular security.
- *Tax disclosure is prepared to support the promotion or marketing of the transaction.* In the context of a Rule 144A offering, we believe that this legend would be flatly incorrect and inconsistent with the disclosure-based policy of the federal securities laws. Disclosure in prospectuses regarding the tax consequences of the proposed investment is provided pursuant to the SEC's requirement that all material information to an investor must be included in the offering document.¹⁰ Securities law liability attaches to this disclosure. As described above, these liability provisions impose a meaningful incentive on issuers and other transaction participants to produce accurate disclosure. Yet Circular 230 would in effect require all tax disclosure to contain a legend that would imply that the tax advice is biased, suspect and unreliable.¹¹

¹⁰ Information is material if a reasonable investor would consider it relevant to a decision to buy, sell or hold a particular security.

¹¹ It is customary for the issuer's counsel to deliver a legal opinion to the underwriters stating that the tax disclosure, to the extent that it constitutes a summary of law or regulations or legal conclusions, fairly (continued...)

- *Tax disclosure cannot be relied upon to avoid penalties.* Inclusion of this legend would suggest that penalties are a realistic possibility. Disclosure in an offering document is presumptively limited to material information, so this legend will suggest (to investors, the SEC staff and potentially to plaintiff's attorneys) that investors face a meaningful risk of tax penalties when in fact that is not the case. The inclusion of this language could lead investors to hire separate tax counsel to evaluate the offering when they otherwise would be satisfied to rely on the tax disclosure with knowledge that they could sue the issuer if it turns out to be materially incorrect. This introduces a potentially significant inefficiency cost as well as a potential delay to capital formation transactions.

These issues could well be justifiable if the IRS has identified abuses in U.S. capital market offerings pursuant to Rule 144A. For example, if tax practitioners were preparing tax disclosure for these offerings that promised investors unwarranted tax benefits or inappropriately downplayed potential tax issues relating to an offered security, the legending requirements of Section 10.35 might be a reasonable regulatory response. In the absence of such abuses, however, we believe that Circular 230 ought to exempt tax disclosure in Rule 144A transactions in the same manner as in SEC-registered offerings.

summarizes such matters in all material respects. A discussion of tax consequences designed to market or promote an offering would likely not meet this standard.

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The Association appreciates this opportunity to provide its views regarding Circular 230. If it would be helpful, we would be happy to make Association staff and member firm personnel available to meet and discuss any of the points raised in this letter. Please address any questions or requests for additional information to Michele C. David of the Association at 646-637-9220.

Very truly yours,

THE BOND MARKET ASSOCIATION

By: /s/ Michele C. David
Michele C. David
Vice President and Assistant General Counsel

cc: Michael J. Desmond
Department of the Treasury
Donald T. Rocen, Deputy Chief Counsel
Internal Revenue Service
The Honorable William H. Donaldson, Chairman
The Honorable Paul S. Atkins, Commissioner
The Honorable Roel C. Campos, Commissioner
The Honorable Cynthia A Glassman, Commissioner
The Honorable Harvey J. Goldschmidt, Commissioner
Alan L. Beller, Director, Division of Corporation Finance
Securities and Exchange Commission